

Message Text

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TO SECSTATE WASHDC 0209

INFO TREASURY WASHDC

ALL US CONSULATES IN MEXICO VIA POUCH

C O N F I D E N T I A L SECTION 1 OF 3 MEXICO 1566

C O R R E C T E D C O P Y (TXT PARA 2.)

LIMDIS

E. O. 11652: GDS

TAGS: EGEN, EFIN, MX

SUBJECT: CURRENT ECONOMIC SITUATION

1. SUMMARY. ECONOMIC ACTIVITY IN MEXICO HAS SLOWED DOWN, WITH OUTPUT RUNNING BELOW MID-76 LEVELS. GOM APPEARS TO BE CONCENTRATING ITS ENERGIES ON REPLACING THE OUTGOING BUREAUCRACY AND EFFECTING AN ADMINISTRATIVE REFORM PROGRAM. WHILE JLP HAS PUBLICLY STATED THAT 1977 WILL BE AN ECONOMICALLY DIFFICULT YEAR AND THAT MEXICO NEEDS A NEW DEVELOPMENT STRATEGY, THERE HAS NOT BEEN MUCH DISCERNABLE PROGRESS IN DEVELOPING EITHER A SHORT-TERM OR LONG-TERM ECONOMIC STRATEGY. PRIVATE SECTOR SEEMS TO BE ADOPTING A WAIT AND SEE ATTITUDE BEFORE UNDERTAKING NEW INVESTMENTS. END SUMMARY.

2. THE RATE OF GROWTH OF INDUSTRIAL ACTIVITY BEGAN TO SLOW IN MID-1976 IN RESPONSE TO THE BANK OF MEXICO'S TIGHT CREDIT POLICIES. THE INDUSTRIAL PRODUCTION INDEX PEAKED IN JUNE, AND HAS RUN AT LOWER LEVELS THROUGH OCTOBER, THE LATEST DATE FOR WHICH IT IS AVAILABLE. THE OCTOBER INDEX IS 140.7, BELOW LEVELS PREVAILING IN THIS MONTH IN THE TWO PREVIOUS YEARS. THE AVERAGE INDEX NUMBER FOR THE FIRST
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SIX MONTHS OF 1976 WAS 144.3, WHEREAS IT WAS 142.1 FOR THE PERIOD JULY-OCT. PARTIAL DATA FOR NOVEMBER IS MIXED, BUT INDEX IS UNLIKELY TO BE HIGHER THAN OCTOBER.

3. MEXICO'S GROSS DOMESTIC OUTPUT IS ESTIMATED TO HAVE GROWN ABOUT 3 PERCENT IN REAL TERMS FROM 1975 TO 1976. MOST OF HSEFRQIIFBBOULD HAVE BEEN IN THE FIRST HALF OF THE

YEAR WITH TOTAL OUTPUT HOLDING STEADY OR DECLINING SLIGHTLY FROM THE FIRST HALF TO THE SECOND HALF. THE PRICE DEFLATOR IS ESTIMATED TO HAVE BEEN ABOUT 20 PERCENT. THE PRELIMINARY BANK OF MEXICO DATA ON NATIONAL ACCOUNTS WILL BE AVAILABLE BY END-FEBRUARY.

4. ACTUAL PRICE DATA IS NOW AVAILABLE FOR THE YEAR 1976. THE YEAR TO YEAR INCREASE IN THE CPI WAS 15.8 PERCENT. THE DECEMBER TO DECEMBER 1976 INCREASE WAS 27.2 PERCENT. THE INCREASE IN THE WPI WAS MORE MARKED, 22.3 PERCENT ON A YEAR TO YEAR BASIS AND 45.9 PERCENT FROM DECEMBER TO DECEMBER. THE WPI IS INFLUENCED BY RAW MATERIAL PRICES, MOST OF WHICH TRADE AT OR CLOSE TO WORLD PRICES.

5. LOPEZ PORTILLO HAS PUBLICLY STATED THAT THE FIRST SIX MONTHS OF 1977 WILL BE PARTICULARLY DIFFICULT AND THAT MEXICO MUST FIND A NEW DEVELOPMENT STRATEGY. WHILE HE ADMITS THAT ECONOMIC PROBLEMS ARE THE MOST PRESSING, THERE IS NOT PUBLIC EVIDENCE THAT THE GOVERNMENT HAS A COHERENT SHORT-TERM ECONOMIC STRATEGY. CONSIDERING THAT THEY HAVE BEEN AWARE OF THE NEED FOR SUCH A POLICY SINCE LAST SEPTEMBER, AND AGREED WITH THE IMF ON THE BROAD OUTLINES OF A MEDIUM TERM ECONOMIC PROGRAM, THE LACK OF ONE IS PARTICULARLY DISAPPOINTING. JLP APPEARS TO HAVE CONCENTRATED HIS ENERGIES ON RESTORING CONFIDENCE AND ORGANIZING HIS ADMINISTRATION. HE HAS BEEN MODERATELY SUCCESSFUL IN THE FORMER, LARGELY BY HIS PUBLIC SPEECHES AND DEMEANOR. THE ORGANIZATION OF HIS GOVERNMENT AND THE ACCOMPANYING ADMINISTRATIVE REFORM

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HAS, ACCORDING TO SOME REPORTS, COMPLICATED THE ABILITY TO DESIGN AND IMPLEMENT ECONOMIC POLICY, PARTICULARLY IN THE FISCAL AREA. RESPONSIBILITIES ARE STILL NOT CLEARLY FIXED. INFORMATION THAT IS KEY TO POLICY DECISIONS IS NOW BEING GATHERED BY DIFFERENT AGENCIES THAN PREVIOUSLY AND IS NOT NECESSARILY FLOWING TO THE VARIOUS POLICY MAKERS. COMMUNICATION BETWEEN MINISTRIES IS REPORTEDLY POOR. WHILE THE PROBLEMS ASSOCIATED WITH THE ADMINISTRATIVE REFORM SHOULD BE TRANSITIONAL, THEY ARE HAVING AN EFFECT ON THE ABILITY TO DESIGN POLICY OPTIONS AND PRESENT THEM TO THE PRESIDENT.

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FM AMEMBASSY MEXICO

TO SECSTATE WASHDC 0210

INFO TREASURY WASHDC

ALL U.S. CONSULATES IN MEXICO VIA POUCH

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LIMDIS

6. THE ECONOMIC POLICY-MAKING PROCESS IN THE NEW GOVERNMENT IS NOT YET CLEARLY DEFINED. AT THE PRESENT TIME THE MINISTER FOR BUDGET AND PLANNING, CARLOS TELLO, APPEARS TO BE THE PREEMINENT, THOUGH NOT NECESSARILY DOMINANT ADVISOR TO THE PRESIDENT. TELLO'S ECONOMIC PHILOSOPHY APPEARS TO FAVOR ACTING AGAINST INFLATION ON THE SUPPLY SIDE. OPPOSED TO HIM ARE THE FINANCIAL OFFICIALS FROM HACIENDA AND BANCO DE MEXICO WHO WANT TO REDUCE INFLATION BY CUTTING BACK DEMAND. KEY PRESIDENTIAL ADVISOR RAFAEL IZQUIERDO IS SAID TO BE SOMEWHERE BETWEEN THESE TWO SCHOOLS OF THOUGHT. THE PRESIDENT SEEMS TO LEAN TO THE FORMER SCHOOL OF THOUGHT PERHAPS BECAUSE HE FEARS THE POLITICAL CONSEQUENCES THAT A REDUCTION IN PER CAPITA CONSUMPTION AND EMPLOYMENT MIGHT HAVE. EVEN AS FINANCE MINISTER AT THE TIME OF THE U.S. RECESSION, JLP TOLD THE AMBASSADOR THAT MEXICO COULD NOT AFFORD A RECESSION BECAUSE OF THE LACK OF SOCIAL WELFARE PROGRAMS TO TAKE CARE OF THE UNEMPLOYED, A THEME HE CONTINUES TO REPEAT.

7. THE JLP ADMINISTRATION'S FIRST INTERNAL POLICY DEBATE IS FOCUSING ON THE BUDGET. THERE IS PRESSURE ON HIM FROM THE BANK OF MEXICO AND HACIENDA TO REDUCE EXPENDITURES
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AS WELL AS TO INCREASE REVENUES, PARTICULARLY BY HIGHER PUBLIC SECTOR PRICES. IT IS POSSIBLE THAT THE DELAYS CAUSED BY THE ADMINISTRATIVE REFORM WILL IMPACT ON THE LEVEL OF EXPENDITURES. WHETHER THIS WILL RESULT IN PERMANENT SAVINGS OR MERELY A BRIEF DELAY IN MAKING EXPENDITURES IS UNKNOWN. THE OUTCOME OF THIS DEBATE

WILL BE THE KEY IN DETERMINING ECONOMIC DEVELOPMENTS LATER IN THE YEAR. WE HAVE HEARD FROM FINANCIAL OFFICIALS THAT JLP HAS ORDERED CUTS IN CURRENT SPENDING BY FEDERAL GOVERNMENT AGENCIES AND HAS INSTRUCTED PUBLIC SECTOR ENTERPRISES TO INCREASE REVENUES OR CUT EXPENDITURES. WE HAVE NOT YET BEEN ABLE TO QUANTIFY THESE POLICIES, NOR HAVE THEY BECOME PUBLIC.

8. APART FROM THE QUESTION OF PUBLIC SECTOR SPENDING, THE GOM IS FACED WITH THE PROBLEM OF FINANCING A CURRENT ACCOUNT DEFICIT WHICH IS BEING FORECAST AT ANYWHERE FROM \$1.8 BILLION TO \$2.6 BILLION. IN ADDITION TO THIS, THE PUBLIC SECTOR'S SHORT-TERM DEBT OF \$4.2 BILLION HAS TO BE ROLLED OVER AND PUBLIC SECTOR LONG-TERM DEBT AMORTIZATION PAYMENTS OF \$1.7 BILLION HAVE TO BE REFINANCED. SOME UNKNOWN QUANTITY OF PRIVATE SECTOR EXTERNAL DEBT--PERHAPS \$4.5 BILLION-- WILL HAVE TO BE REFINANCED AS WELL.

9. MEXICO'S FINANCIAL PROBLEM IS TWOFOLD AND INTER-RELATED. THAT IS, THE GOM NOT ONLY HAS TO FINANCE A SUBSTANTIAL BUDGET DEFICIT, THE SIZE OF WHICH WILL IMPACT ON THE EXTERNAL ACCOUNTS, BUT IT ALSO HAS TO ARRANGE, ONE WAY OR ANOTHER, FOR SUBSTANTIAL GROSS FOREIGN BORROWING. THE LATTER IS THE PRIMARY CONCERN OF THE GOM.

10. WHILE SENIOR GOM OFFICIALS OFTEN STATE THAT MEXICO CANNOT AFFORD A RECESSION, THE ECONOMY IS IN CONFIDENTIAL

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A RECESSION ACCORDING TO THE INFORMAL MEXICAN DEFINITION, I.E., A NEGATIVE PER CAPITA GROWTH RATE. THIS "RECESSION" MAY BE WORSE THAN COMMONLY BELIEVED. INDUSTRIAL ACTIVITY MAY BE LOWER NOW THAN IT WAS IN OCTOBER. THIS JUDGEMENT IS BASED ON THE FOLLOWING FACTORS. (1) THE INDUSTRIAL WORK FORCE IS PROBABLY LOWER NOW THAN LAST SUMMER. VARIOUS BUSINESSMEN HAVE TOLD US THAT THEY ARE LAYING OFF WORKERS. (2) PUBLIC SECTOR SPENDING IS PROBABLY RUNNING BELOW THE BUDGET DUE TO THE REORGANIZATION OF THE ENTIRE PUBLIC SECTOR. WE HEAR REPORTS OF MAJOR SPENDING DECISIONS BEING DELAYED. PUBLIC SECTOR SPENDING HAS BEEN THE UNDERPINNING OF MEXICO'S ECONOMIC GROWTH SINCE 1972. (3) PRIVATE INVESTMENT WAS UNDOUBTEDLY AFFECTED NEGATIVELY BY THE EVENTS OF LAST FALL. THE LACK OF ABILITY TO FORECASE ECONOMIC DEVELOPMENTS AND EXHCANGE RATE DEVELOPMENTS, IN PARTICULAR, WITH ANY CERTAINTY IS AFFECTING INVESTMENT DECISIONS.

MANY PRIVATE BUSINESSMEN SAY THEY ARE WAITING TO SEE SPECIFIC ECONOMIC MEASURES RATHER THAN BASE INVESTMENT DECISIONS ON MORAL SUASION. (4) FOREIGN EXCHANGE TRANSACTIONS ARE REPORTEDLY DECLINING. THIS MAY INDICATE A CONTINUED DECLINE IN IMPORTS THAT BEGAN LAST SEPTEMBER AND WOULD IN TURN AFFECT DOMESTIC ECONOMIC ACITIVITY. (5) INCREASED PESO AND DOLLAR FINANCING IS NOT AVAILABLE TO MEXICO'S PRIVATE SECTOR, NOR HAS IT BEEN FOR SOME MONTHS.

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FM AMEMBASSY MEXICO

TO SECSTATE WASHDC 0211

INFO TREASURY WASHDC

ALL U.S. CONSULATES IN MEXICO VIA POUCH

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LIMDIS

11. WHILE IT IS TOO EARLY TO GAIN A CLEAR PICTURE ON THE AGRICULTURAL OUTLOOK, THE IMPACT OF THE LAND SEIZURES IN NORTHWEST MEXICO WAS CERTAINLY NOT CONDUCIVE TO INCREASED PRIVATE SECTOR INVESTMENT IN AGRICULTURE AND WILL HAVE A NEGATIVE IMPACT ON OUTPUT IN THAT REGION--PARTICULARLY WHEAT. WHEAT ACREAGE WAS DOWN BY ONE-THIRD IN SONORA AND PLANTING DELAYS DUE TO THE LAND TENURE PROBLEM WILL PROBABLY REDUCE YIELDS. IMPORTS IN EXCESS OF 500,000 TONS ARE PROJECTED FOR THE 1977/78 MARKETING YEAR(SEE MEXICO 0819). ON THE OHTER HAND, PROSPECTS FOR EXPORT CROPS SUCH AS COFFEE AND COTTON ARE BRIGHT BECAUSE OF HIGH PRICES AND FRUIT AND VEGETABLE EXPORTS SHOULD GET A BOOST FROM THE FLORIDA FREEZE.

12. OUR JUDGEMENTS IN THE PRECEEDING TWO PARAGRAPHS ARE OHEMELY# QUALITATIVE BECAUSE OF THE LACK OF CURRENT DATA ON WHICH TO BASE AN ANALYSIS. HOWEVER,

WE THINK THE INDIRECT SIGNS OF FURTHER ECONOMIC SLOW-DOWN ARE SIGNIFICANT ENOUGH TO REPORT.

13. THE GOM IS UNDOUBTEDLY AWARE OF THOSE SIGNS
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AND THE PROSPECT OF CONTINUED STAGNATION OR EVEN FURTHER DECLINES IN ECONOMIC ACTIVITY MAY BE ONE OF THE REASONS JLP COULD OPT FOR A RELATIVELY HIGH LEVEL OF PUBLIC SECTOR SPENDING EVEN THOUGH THIS MEANS MORE FOREIGN FINANCING THAN WOULD OTHERWISE BE NECESSARY.

14. THE CURRENT ECONOMIC SLOWDOWN IS A MIXED BLESSING. IT SHOULD LEAD TO A REDUCTION IN THE CURRENT ACCOUNT DEFICIT AND, IF THERE ARE ACTUAL BUDGET SAVINGS, MAKE ATTAINMENT OF EFF PROGRAM TARGETS SOMEWHAT MORE LIKELY. ON THE OTHER HAND, JLP IS UNLIKELY TO BE SATISFIED OF WHAT HE VIEWS AS THE POLITICAL RISKS FROM REDUCED EMPLOYMENT AND PER CAPITA CONSUMPTION.

15. ALTHOUGH SIGNIFICANT TURNAROUND IN ECONOMIC ACTIVITY COULD HARDLY HAVE BEEN EXPECTED WITHIN TWO MONTHS OF TAKING OFFICE, WE BELIEVE THE SUSPECTED DETERIORATION IN THE ECONOMIC SITUATION COULD HAVE BEEN MITIGATED BY MORE POSITIVE ACTION BY THE NEW GOVERNMENT. IN PARTICULAR, WHILE JLP HAS STATED THAT THIS WILL BE A DIFFICULT PERIOD, NEITHER HE NOR OTHER GOM SPOKESMEN HAVE LAID OUT IN ANY DETAIL WHAT THE MEXICAN BUSINESS COMMUNITY AND PUBLIC MIGHT EXPECT IN 1977. THIS HAS NEVER BEEN DONE IN MEXICO, BUT IT IS IMPORTANT IN THE PRESENT CONTEXT BECAUSE THE ECONOMIC POLICY FRAMEWORK THAT PREDOMINATED FOR OVER TWENTY YEARS AND PROVIDED A BASIS FOR PLANNING DISAPPEARED WITH THE DEVALUATION.

16. SOME AREAS WHERE COHERENT POLICIES HAVE NOT YET BEEN DEVELOPED ARE THE FOLLOWING:
(A) EXCHANGE RATE POLICY. (FLUCTUATIONS IN THE RATE ARE GENERALLY ATTRIBUTED TO CHANGES IN SUPPLY AND DEMAND. GOM HAS NOT SAID PUBLICLY THAT EXCHANGE RATE
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MIGHT ALSO BE DETERMINED BY SUCH OBJECTIVES AS REDUCING THE CURRENT ACCOUNT DEFICIT AND MAKING

MANUFACTURED EXPORTS COMPETITIVE IN WORLD MARKETS.)

(B) INTEREST RATE POLICY. (HIGHER INTEREST RATES ON PESO DEPOSITS WILL BE NECESSARY TO RETAIN EXISTING PESO FINANCIAL SAVINGS AND ATTRACT MORE PESOS INTO BANKING SYSTEM.)

(C) FISCAL POLICY. (IDEALLY, SOME TARGET FIGURE FOR BUDGET CUTS COULD BE ANNOUNCED ALONG WITH A REVENUE INCREASE TARGET. THE DETAILS NEED NOT BE MADE PUBLIC AT THIS TIME. THE INTENTION TO PURSUE A LESS INFLATIONARY POLICY WOULD BE REASSURING TO FOREIGN BANKERS AND TO LOCAL BUSINESSMEN WHO WANT FINANCIAL STABILITY.)

(D) WAGE GUIDANCE. (THE 10 PERCENT MINIMUM WAGE INCREASE OF LAST DECEMBER IS BEING INTERPRETED AS A GUIDELINE FOR SETTLEMENTS OF INDIVIDUAL UNION CONTRACTS. IT MAY NOT BE POSSIBLE FOR THE GOM TO DO MORE.)

17. WHILE JLP HAS PREPARED THE COUNTRY FOR BAD ECONOMIC NEWS, HE HAS NOT PROVIDED ANY DETAILS. THE ECONOMIC SITUATION IS CONFUSED AND THE ECONOMIC CLIMATE IS RADICALLY DIFFERENT FROM WHAT IT WAS EVEN A YEAR AGO. CONFUSION COMPLICATES PLANNING AND INVESTMENT. IT ALSO DELAYS THE NECESSARY STRUCTURAL CHANGES IN THE ECONOMY. THE PUBLIC DOES NOT UNDERSTAND GOM OBJECTIVES. WITHOUT GUIDANCE, STAGNATION IS LIKELY TO LAST LONGER THAN WOULD OTHERWISE BE NECESSARY. FURTHER, THE FOREIGN BANKING COMMUNITY IS UNLIKELY TO BE AS SUPPORTIVE AS IT COULD BE IN THE LIGHT OF THIS UNCERTAINTY.

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